



STATE OF TENNESSEE COMPTROLLER OF THE TREASURY

DEPARTMENT OF STATE

Performance Audit Report

September 2018

Justin P. Wilson, Comptroller



Division of State Audit

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Mission Statement
The mission of the Comptroller's Office is
to make government work better.

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JUSTIN P. WILSON
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September 4, 2018

The Honorable Randy McNally
Speaker of the Senate
The Honorable Beth Harwell
Speaker of the House of Representatives
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Tre Hargett
Secretary of State
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Department of State for the period July 1, 2016, through June 30, 2018.

Our audit resulted in no audit findings.

Sincerely,

A handwritten signature in black ink that reads "Deborah V. Loveless". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Deborah V. Loveless, CPA
Director

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18/068



**Division of State Audit
Department of State
Performance Audit
September 2018**

Our mission is to make government work better.

AUDIT HIGHLIGHTS

The Department of State's mission is to exceed the expectations of our customers, the taxpayers, by operating at the highest levels of accuracy, cost-effectiveness, and accountability in a customer-centered environment.

We have audited the Department of State for the period July 1, 2016, through June 30, 2018. Our audit scope included a review of internal controls and compliance with laws, regulations, policies, and procedures, in the following areas:

- information systems;
- Administrative Procedures Division, conflict-of-interest and disclosure of personal interests;
- fantasy sports; and
- elections.

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INTRODUCTION

AUDIT AUTHORITY

This is the report on the performance audit of the Department of State. Section 8-4-109, *Tennessee Code Annotated*, states the following:

The comptroller of the treasury is hereby authorized to audit any books and records of any governmental entity created under and by virtue of the statutes of the state of Tennessee which handles public funds when such audit is deemed necessary or appropriate by the comptroller of the treasury. The comptroller of the treasury shall have the full cooperation of officials of the governmental entity in the performance of such audit or audits.

The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which requires the Department of Audit to audit all accounts and financial records of any state department, institution, office, or agency in accordance with both generally accepted auditing standards and procedures established by the Comptroller. An audit may include any or all of the following elements: financial, compliance, economy and efficiency, program results, and program evaluations.

The department's organizational chart is on page 4.

BACKGROUND

The Secretary of State is one of the three constitutional officers provided by Tennessee's constitution and is elected by the General Assembly for a four-year term. The Secretary of State, according to the constitution, is to maintain a register of the official acts and proceedings of the Governor and is to be prepared to present them before the General Assembly.

The Secretary of State is the chief executive officer of the Department of State. The Department of State keeps all acts and resolutions adopted by the General Assembly, proclamations of the Governor, executive orders, and oaths of office. The department is also required by statute to keep other records such as the receipt and recording of corporate charters and annual reports, the receipt of trademarks, the execution of notary commissions, and the processing of state administrative rules and regulations.

The office of the Secretary of State is located on the first floor of the state capitol and employs numerous positions that support the direction, coordination, and supervision of the department's various divisions.

The department is also organized into nine functional divisions: Fiscal and Administrative Services; Information Technology; Administrative Procedures; Business Services; Charitable Solicitations, Fantasy Sports, and Gaming; Elections; State Library and Archives; Publications; and Records Management.

Fiscal and Administrative Services Division

The Fiscal and Administrative Services Division provides the general administrative services necessary to support the department. These include budgeting, accounting, procurement, payroll, and other administrative financial services, as well as managing the department's staffing, benefits, employee relations, policies, compliance, and recruiting.

Information Technology Division

The Information Technology Division is responsible for all information technology services necessary to the department. These responsibilities include information systems and technology planning; project development and implementation; technical support; network and telephone administration; website infrastructure; and procurement assistance.

Administrative Procedures Division

The Administrative Procedures Division provides administrative judges to conduct contested case hearings for state administrative agencies and develops uniform rules of procedures for the conduct of those hearings. This division is also required to assist state agencies in complying with the Uniform Administrative Procedures Act (Title 4, Chapter 5, *Tennessee Code Annotated*).

Business Services Division

The Business Services Division executes the processing and recordkeeping duties of the Secretary of State in the following areas: apostilles and authentications, corporations, general partnerships, limited liability corporations, limited liability partnerships, limited partnerships, mine foreman certificates, motor vehicle temporary liens, nonresident fiduciary appointments, notary commissions, service of process, state deeds and leases, trademarks, Uniform Commercial Code, and workers' compensation exemption registrations. According to the department's website, the division assists approximately 9,500 persons monthly, processing on average 46,875 documents per month. Additionally, the division maintains certain business information on its searchable databases. Some of this information includes business name, principal office address, registered agent, and business status. Its databases are most often used by businesses, citizens, and the law enforcement community. Documents may be filed by mail; in person; and others are available to be filed online.

Charitable Solicitations, Fantasy Sports, and Gaming Division

The Charitable Solicitations, Fantasy Sports, and Gaming Division is responsible for registering and regulating charitable organizations that solicit contributions within the state of Tennessee, as well as professional solicitors that assist charitable organizations in those activities. The division reviews annual gaming event applications, determines qualifying applicants for annual gaming events for approval by the General Assembly, and regulates those annual events. The division executes the processing and recordkeeping duties of the Secretary of State relating to athlete agent registration, and it regulates catastrophic illness trusts and fantasy sports.

Elections Division

The Elections Division is responsible for coordinating the activities of county election commissions and the uniformity of election procedures throughout the state. The coordinator interprets questions of the law for the benefit of all election officials, reviews election law legislation, and prepares the election manual and election handbooks for use by election officials. The division also certifies county administrators and provides training to county election commissions.

State Library and Archives Division

The Tennessee State Library and Archives Division collects and preserves books and records of historical, documentary, and reference value and encourages and promotes library development throughout the state.

Publications Division

The Publications Division publishes the Tennessee Blue Book and the Public and Private Acts of the General Assembly. The division also maintains the Tennessee Administrative Register, the compilation of rules and regulations of the State of Tennessee, reports required by the Open Appointments Act, and other filings required by law.

Records Management Division

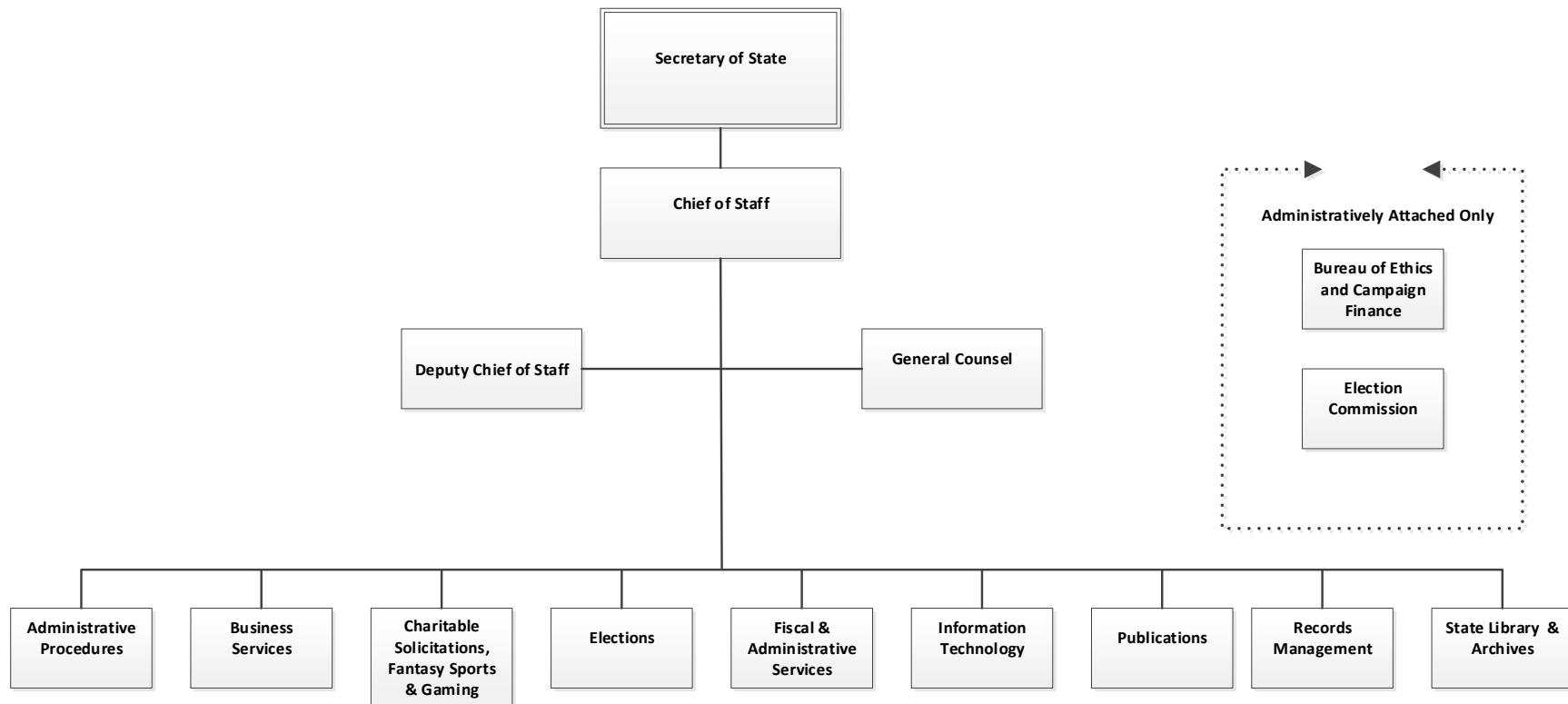
The Records Management Division was established by Section 10-7-303, *Tennessee Code Annotated*, to help state agencies establish systematic controls for the efficient use and sound preservation of state records. As the primary records management agency for the State of Tennessee, the division provides agencies with professional consultative and analytical records management leadership. This support assists with the disposition, retention, and destruction of records. The division is further directed by the Public Records Commission (PRC) to serve as administrative liaison between state agencies and the PRC; to establish procedural guidelines for paper and electronic records oversight and retention; and to coordinate efforts supporting the state's Paperwork Reduction and Simplification Act of 1976 (Section 4-25-101, *Tennessee Code Annotated*).

Administratively Attached Entities

The department also provides administrative support to the State Election Commission and the Bureau of Ethics and Campaign Finance for all matters relating to receipts, disbursements, expense accounts, budgets, audits, and other related items.¹

¹ The Bureaus of Ethics and Campaign Finance and the State Election Commission are covered under the Tennessee Governmental Entity Review Law and were not included in the scope of our audit.

Department of State
Organizational Chart
June 2018



Source: Department of State management.

AUDIT SCOPE

We have audited the Department of State for the period July 1, 2016, through June 30, 2018. Our audit scope included a review of internal controls and compliance with laws, regulations, policies, and procedures in the following areas:

- information systems;
- Administrative Procedures Division, conflict-of-interest and disclosure of personal interests;
- fantasy sports; and
- elections.

Department management is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, policies, and procedures.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient, appropriate audit evidence to support the conclusions in our report. Although our sample results provide reasonable basis for drawing conclusions, the errors identified in these samples cannot be used to make statistically valid projections to the original populations. We present more detailed information about our methodologies in the individual sections of this report.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

PRIOR AUDIT FINDING

REPORT OF ACTIONS TAKEN ON PRIOR AUDIT FINDING

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The prior audit report was dated August 2016 and contained one finding. The Department of State filed its report with the Comptroller of the Treasury on December 22, 2016. We conducted a follow-up of the prior audit finding and observation as part of the current audit.

RESOLVED AUDIT FINDING AND OBSERVATION

The current audit disclosed that the Department of State resolved the previous audit finding concerning inadequate internal controls in two specific areas² and the observation concerning Administrative Procedures Division employees not completing disclosure of personal interest forms annually.

AUDIT CONCLUSIONS

INFORMATION SYSTEMS

The Department of State relies on various information systems, databases, and applications to capture and maintain information that supports the department's activities. The Information Technology Division is responsible for maintaining the department's computer systems and applications.

Audit Results

Audit Objective: Did management follow state information systems policies and industry best practices?

Conclusion: Based on the procedures performed, we determined that management did follow state information systems policies, with minor exceptions.

Methodology To Achieve Objective

To achieve our objective, we interviewed management and obtained relevant documentation to gain an understanding of the department's systems' control activities and assessed management's adherence to state information systems policies and industry best practices.

ADMINISTRATIVE PROCEDURES DIVISION, CONFLICT-OF-INTEREST AND DISCLOSURE OF PERSONAL INTERESTS

The Department of State's Administrative Procedures Division oversees Administrative Law Judges (administrative judges), whose main duty is to resolve disputes between government agencies and citizens in an impartial and independent manner. The department uses a formal conflict-of-interest statement and an annual disclosure of personal interests form for all employees, including employees in the Administrative Procedures Division.

² This finding is designated as Limited Official Use Only and it contains information that is protected under Section 10-7-504(i), *Tennessee Code Annotated*.

The department requires its employees to disclose any potential conflicts of interest by

- signing a formal conflict-of-interest statement, which serves as an acknowledgement that the employee has read the department's conflict-of-interest policy; and
- completing and signing an annual disclosure of personal interests form to ensure that the employee continually and frequently communicates any conflicts of interest.

By requiring administrative judges and staff to sign the disclosure form, management has documented assurance that the administrative judges and staff have periodically considered personal conflicts that could hinder the performance of their duties.

Audit Results

Audit Objective: Did management ensure the division's staff members and administrative judges submitted their conflict-of-interest statements and annual disclosure of personal interest forms (disclosure forms) timely?

Conclusion: Management ensured Administrative Procedures Division employees submitted their conflict-of-interest statements and disclosure forms timely.

Methodology To Achieve Objective

To achieve our objective, we obtained a list of all 26 employees within the division as of April 24, 2018. The employee population consisted of 18 administrative judges and 8 support staff. We reviewed conflict-of-interest statements and disclosure forms for calendar years 2017 and 2018 for all 26 employees within our population. In addition, we reviewed the department's conflict-of-interest policy pertaining to collecting, retaining, and updating conflict-of-interest statements and disclosure forms. We then interviewed the Assistant Director of Human Resources and Organizational Development regarding retention and collection of conflict-of-interest statements and disclosure forms.

FANTASY SPORTS

Operators

The Fantasy Sports Act of 2016 requires fantasy sports operators to obtain a license to operate through the Division of Charitable Solicitations, Fantasy Sports, and Gaming. Currently, seven fantasy sports operators are licensed to operate in Tennessee. The license requirement applies to fantasy sports operators who offer daily and season-long contests that charge players an entry fee to assemble imaginary teams of athletes and are subsequently offered prizes based on the outcome of those games. Any person seeking to be a licensed fantasy sports operator must submit an application along with a \$300 application fee. Licensing also requires the operator to submit financial documents and maintain segregated player funds.

Upon receiving a fully completed application, the division has 30 days to review and approve or deny the application. Each license issued is valid for one year following the date of the division’s notification of approval. Within 10 days of receiving the notification letter approving the application, an approved licensee must remit a licensure fee to the division according to the fee schedule outlined in Chapter 1360-03-05-.05(3) of the *Rules and Regulations of the Tennessee Department of State, Division of Charitable Solicitations Fantasy Sports Section, Rules Related to the Fantasy Sports Act*.

All licensed fantasy sports operators must submit both annual reporting and audit reports to the division. The annual report requires operators to disclose Tennessee consumer account information, which includes information such as the total number of accounts, entry fees received, and prizes awarded to Tennessee consumers. The audit report requires two components: a financial audit and a compliance audit. The financial audit includes an audit of the operator’s financial operations and handling of player accounts and funds pursuant to the Fantasy Sports Act, and it must be prepared by a certified public accountant consistent with the attestation standards established by the American Institute of Certified Public Accountants. The compliance audit includes a performance audit to verify compliance with the operational aspects of the Fantasy Sports Act, and it must be prepared by a testing laboratory recognized by the Secretary of State as an entity approved to conduct compliance audits.

Fantasy Sports Fund

By statute, all fantasy sports fees and penalties collected by the Secretary of State associated with the administration of the Fantasy Sports Act, must be deposited into a fund known as the “Fantasy Sports Fund.” According to Section 47-18-1607(b), *Tennessee Code Annotated*, “All costs of the secretary of state associated with the administration of the Fantasy Sports Act must be paid from this fund”. See Table 1 for the revenues and expenditures for the Fantasy Sports fund for Fiscal Year 2017 and Fiscal Year 2018 as of May 31, 2018.

Table 1
Fantasy Sports Fund
By Fiscal Year
(Unaudited)³

	2017	2018
Revenues	\$160,515.96	\$148,178.43
Expenditures	\$45,216.51	\$87,026.48

Audit Results

- 1. Audit Objective:** Did management review and approve the application for licensure of fantasy sports operators in accordance with the Fantasy Sports Act?

³ Source: Edison, state’s accounting system. For fiscal year ending June 30, 2018, we present estimated data through May 31, 2018, since the state’s books and fiscal year end, June 30, 2018, had not occurred at the end of our fieldwork.

Conclusion: Management reviewed and approved the application for licensure of fantasy sports operators in accordance with state law.

2. Audit Objective: Did management maintain a registry of fantasy sports operators licensed to operate in Tennessee?

Conclusion: Management maintained a registry of fantasy sports operators licensed to operate in Tennessee.

3. Audit Objective: Did management ensure that all licensed fantasy sports operators submitted annual reporting and audits as outlined in the *Rules and Regulations of the Tennessee Department of State, Division of Charitable Solicitations Fantasy Sports Section, Rules Related to the Fantasy Sports Act*?

Conclusion: Management ensured that all licensed fantasy sports operators submitted annual reporting and audits as outlined in the Fantasy Sports Act.

4. Audit Objective: Did management examine and inspect audit reports submitted by licensed fantasy sports operators in accordance with state law?

Conclusion: Management examined and inspected audit reports submitted by licensed fantasy sports operators in accordance with state law.

5. Audit Objective: Did management ensure that only expenditures associated with the administration of fantasy sports were paid from the Fantasy Sports Fund and that they were properly approved?

Conclusion: Based on our testwork, the department ensured that only expenditures associated with the administration of fantasy sports were paid from the Fantasy Sports Fund and that they were properly approved.

Methodology To Achieve Objectives

Operators

To meet our objectives, we interviewed the Director of Fantasy Sports, the Fantasy Sports Compliance Analyst, and the department's General Counsel. We reviewed the Fantasy Sports Act; *Rules and Regulations of the Tennessee Department of State, Division of Charitable Solicitations Fantasy Sports Section, Rules Related to the Fantasy Sports Act*; and the registry of licensed fantasy sports operators contained on the Secretary of State's website.

To test our objectives, we obtained a list of all seven fantasy sports operators registered with the department for the period of July 1, 2016, through June 30, 2018. We obtained and reviewed the operators' applications used to apply for and renew licensure; correspondence letters indicating the department's approval of licensure and certification; and a compliance tracking

spreadsheet maintained by the department to determine if audit reports were submitted timely and subsequently reviewed by the Fantasy Sports Compliance Analyst.

Fantasy Sports Fund

To gain an understanding of internal controls related to the processing of expenditures used in administering the Fantasy Sports Act, we interviewed the Assistant Director of Fiscal and Administrative Services and reviewed documented procedures for approving invoices in Edison (the state's accounting system). We obtained and reviewed invoices and supporting documentation contained in Edison; documentation supporting the reallocation of personnel and telecommunications costs; and employee timesheets. We obtained a population of 93 expenditures totaling \$77,243 containing a fantasy sports allotment code that were recorded in Edison during the period July 1, 2016, through January 31, 2018. From the 93 expenditures, we tested a random, nonstatistical sample of 25 expenditures totaling \$16,104 to determine if the expenditures were associated with the administration of the Fantasy Sports Fund and were properly approved.

ELECTIONS

The coordinator of elections (coordinator) position was created in 1959 by the General Assembly and is appointed by the Secretary of State. The coordinator oversees the election process in the State of Tennessee and works directly with 95 local county election commissions, candidates, and the public on election-related issues. The coordinator also provides training to county election commissions. Section 2-11-202(a)(18)(A), *Tennessee Code Annotated*, provides that the coordinator shall conduct a training seminar, at least once per calendar year, for administrators, deputies, and county election commissioners. Training seminars include topics related to safeguarding elections such as risk management, physical security, computer security, information security, and cyber security.

In addition, the Department of State developed and presented a data security standard to encourage and enhance voter data security and to facilitate the broad adoption of consistent data security measures across the state. This security standard provides a baseline of technical and operational requirements designed to protect voter data, and it applies to all 95 counties in the State of Tennessee.

Audit Results

Audit Objective: Did the coordinator of elections conduct a training seminar at least once per calendar year as required by statute?

Conclusion: The coordinator of elections conducted a training seminar at least once per year as required by statute.

Methodology To Achieve Objective

To meet our objective, we interviewed the coordinator of elections and reviewed Section 2-11-202(a)(18)(A), *Tennessee Code Annotated*, to gain an understanding of the training seminar requirement. We obtained and reviewed the training agenda, attendance documentation, and seminar packets for calendar year 2017 and calendar year 2018 as of June 30, 2018.

APPENDICES

Appendix 1 **Business Unit Codes**

30501 Secretary of State
30502 State Election Commission
30503 Public Documents
30504 State Library & Archives
30505 Regional Libraries
30506 Library Construction
30507 Bureau of Ethics & Campaign Finance
30509 Charitable Solicitations & Gaming
30510 Help America Vote Act
30512 Community Enhancement Grants
30513 Records Management
30514 Fantasy Sports

Appendix 2
Financial Information for Fiscal Years Ending June 30, 2017, and June 30, 2018

Budget and Actual Expenditures and Revenues
Fiscal Year Ending June 30, 2017

Department of State		Recommended Budget*	Actual Expenditures and Revenues**
Expenditures	Payroll	\$13,905,100	\$11,554,800
	Operational	3,615,700	3,909,100
	Total	\$17,520,800	\$15,463,900
Revenues	State	\$10,362,500	\$4,289,600
	Federal	300,000	0
	Other	6,858,300	11,174,300
	Total	\$17,520,800	\$15,463,900

*Source: Tennessee State Budget, Fiscal Year 2016-2017.

**Source: Tennessee State Budget, Fiscal Year 2018-2019.

Budget and Estimated Expenditures and Revenues
Fiscal Year Ending June 30, 2018⁴

Department of State		Recommended Budget*	Estimated Expenditures and Revenues**
Expenditures	Payroll	\$14,538,000	\$15,398,800
	Operational	3,677,200	3,830,100
	Total	\$18,215,200	\$19,228,900
Revenues	State	\$11,056,900	\$12,070,600
	Federal	300,000	300,000
	Other	6,858,300	6,858,300
	Total	\$18,215,200	\$19,228,900

*Source: Tennessee State Budget, Fiscal Year 2017-2018.

**Source: Tennessee State Budget, Fiscal Year 2018-2019.

⁴ During our audit work, fiscal year ending June 30, 2018, had not been closed; therefore, we presented the estimated revenues and expenditures for that period.